paper currency will indeed be stationary; but the value of this paper currency, and consequently of the money incomes in terms of gold will have increased. It would be interesting to examine the significance of such appreciation, but this lies beyond the scope of the present critique.

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A REJOINDER

I SHALL confine my comments on Professor Hollander's strictures to the case which he himself chiefly considers, namely, that of lending operations between countries both of which are on a specie basis. It is somewhat a matter of surprise to me that such operations need further elucidation; for the " pure " theory of international trade on this range of topics might be supposed to have been settled. The paper which Professor Hollander criticizes was designed to analyze mainly the more difficult and unsettled case in which one of the countries is on an inconvertible paper basis, and the normal specie conditions were considered only by way of introduction.

Let it be borne in mind that both Professor Hollander and myself are discussing the accepted (Ricardian) theory, and that neither of us undertakes here to correct or to verify it. The complexities of modern international transactions and modern monetary conditions may compel revision of the traditional reasoning. But these are matters that do not touch the questions here under debate.

The basis upon which Professor Hollander's reasoning rests is indicated in his statement of my own starting point: "the starting point of Professor Taussig's analysis is the inference that if both borrowing and lending countries are on a gold basis, and if trade between them is at equilibrium, the loan transaction will be accompanied by a movement of gold. This conclusion I take to be erroneous." On this

cardinal point I am convinced, for my part, that Professor Hollander is in error.

Professor Hollander believes that specie cannot flow out of a country unless the stock of gold in it is "redundant." In his opinion there must be a "relative excess of specie." Gold will not flow except (quoting Ricardo) "when it is superabundant." Only if there is a "special transaction" (by which is meant a set of dealings in which it is specifically stipulated that gold shall be remitted) will the metal move. It is commodities that will move from the lending countries to the borrowing; and they will move at once, without any previous flow of specie.

Apparently Professor Hollander has a general belief that specie will flow from country to country only if something has previously happened which has altered in one of them the relation between the quantity of the circulating medium and the volume of commodities exchanged. There must be (so his reasoning seems to run) either increased production from the mines, or an issue of paper money, or a decrease in the volume of commodities exchanged in the country — some influence of this sort, which serves to alter the general price level, brings about what he calls a redundancy of the currency, and so causes specie to move.

Is it not in plain disregard of familiar facts, and in plain disregard of accepted theory, to assume that gold can flow only under conditions of this sort? Let one case be recalled, a case which plays so large a part in Mill's well known chapters on the theory of international value. Suppose a change in the conditions of demand — simply this and nothing more. Country A and country B are trading. In country B the demand for commodities obtained from country A becomes less; in the language which later theory has taught us, the demand schedule for the commodities shifts in B to the left. Country A no longer can send to country B, at the same prices, as many commodities as before. The difference must be made up by remittance of specie. Gold flows from country A to country B, solely in consequence of the change in the conditions of demand. That flow of specie continues until (fol-

lowing the well known course of reasoning) a new equilibrium is reached between country A and country B. Permanently lowered prices result in A, permanently raised prices in B. There has been no " redundancy " of currency in A; nothing whatever to cause the outflow of specie except the change in demand. Yet, assuming this to be the sole change that disturbs the previous equilibrium, the movement of specie must take place.

Precisely the same happens if tourists from country A betake themselves in large numbers to country B and spend money in the latter. Remittance from A has to be made in some form or another, and the remittance will take first the form of specie. As we all know, if this sort of expenditure goes on year after year, it brings about eventually an increase of commodity exports from country A and a so-called favorable balance of trade. But that balance of trade does not set in automatically. It ensues as the *result* of a flow of specie and of consequent changes in the price levels.

Other causes for remittance, bringing the same consequences, can be readily adduced. If a large number of persons in country A should remit to their relatives in country B, in order to enable the latter to immigrate into country A, and if there were a steady continuance of remittances of this sort, there would ensue in the end an increased volume of exports from country A; but here again the first stage would be a flow of specie out of that country. The reader will observe that these two cases (tourist and immigrant remittances) represent what in fact has taken place as regards the United States during the last generation or two.

Coming now to the particular subject in hand, loan transactions are precisely of the sort just indicated; that is, they are transactions in which the flow of specie takes place without there having been any previous " redundancy." Surely it cannot be maintained that such transactions would bring about a movement of commodities from the lending country merely through the disturbances of foreign exchange within the limits of the gold points. Fluctuations in exchange rates within these limits are never more than a minor factor as

regards commodity exports and imports. Further, it is to be remembered — I trust the assumption is indicated with sufficient clearness in the article criticized by Professor Hollander — that the lending operations are supposed to be continuous; not sporadic, but going on through a series of years. This being the case, we have a situation which, so far as the flow of specie is concerned, is precisely like that ensuing because of a change in demand, of tourists' remittances, and the like. The first stage in the establishment of a new equilibrium is a flow of specie, without previous "redundancy."

On still another phase of lending transactions between specie countries I find myself differing with Professor Hollander. In the tabular statement which he gives on page 687, the sequence of events in the lending country is stated as follows (gold being supposed by him to move, in the way of a supposed exception, in consequence of a "special transaction"):

1. Efflux of gold.
2. Falling prices.
3. Reduced imports; increased exports.
4. Less goods.
5. Rising prices.

In this the fifth item is open to criticism. The assumption is that after a period of falling prices there comes a succeeding period of rising prices; in other words, that the stage of lowered prices is not definitive, but is followed by something in the nature of a rebound. I am convinced that on this point Professor Hollander is mistaken, and that the mistake arises from an inadequate analysis of the theoretical situation. In all such cases as have been referred to in the preceding discussion — a change in demand, tourist expenditure, immigrant expenditure, lending operations — a *definitive* change in the relative price levels takes place. It is a common error, in dealing with this phase of economic theory, to suppose that when such a fall of prices takes place (say from a change in demand) it is followed by an increase of exports, and then by a rebound in the nature of a rise in prices. No; a new equilibrium is established, with commodity exports from the

lending country regularly exceeding its imports, no further flow of specie, prices lower once for all in this country, and higher once for all in the borrowing country.

At a later stage in the lending operations — quite a different stage — there will indeed presumably come a "rebound." This turn will appear much later, after the lending country has long continued its investments, and when finally the interest received on old loans begins to exceed the principal remitted on loans newly made. Then (in the course of the transition leading to this new stage) specie will flow the other way — toward the lending country. Prices will rise in it, its imports will increase, and eventually an equilibrium of just the reverse kind will be attained: commodity imports will exceed the exports, and there will be an "unfavorable" balance of trade. All this is familiar enough in theory. In practice the lending operations do not take place with the smoothness, continuity, regularity, which may be assumed for the purposes of theory; nor does the eventual reversal of trade conditions take place with the assumed gradual and easily discernible transition. But, in the large, these several stages can be made out in the history of Great Britain's international trade during the nineteenth century. All this, however, relates to a "rebound" of quite a different kind from that sort of early rebound which Professor Hollander's reasoning implies.

Differing as I do on the comparatively simple case of transactions between specie countries, it does not seem necessary to follow Professor Hollander on the more complex case of transactions between a specie country and a paper country. I find myself unable to accept his reasoning on many aspects of this case also. But the conversant reader will judge for himself; and without further comment the decision on the merits of this friendly debate may be left to turn on the plain and simple case with which both of us start.

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